No. 3953

In The United States Circuit Court of Appeals

For The Ninth Circuit

FORBES P. HASKELL, as Receiver of SCANDINAVIAN-AMERICAN BUILDING COMPANY, a Corporation, et al., *Appellants*,

vs.

McCLINTIC-MARSHALL COMPANY, a Corporation, et al., *Appellees*.

TACOMA MILLWORK SUPPLY COMPANY, a Partnership consisting of ANN DAVIS and R. T. DAVIS, Jr., as Executors of the Estate of R. T. DAVIS, Deceased, R. T. DAVIS, Jr., LLOYD DAVIS, HARRY L. DAVIS, GEORGE L. DAVIS, MAUDE A. DAVIS, MARIE A. DAVIS, RUTH G. DAVIS, HATTIE DAVIS TENNANT and ANN DAVIS, *Appellants*,

vs.

McCLINTIC-MARSHALL COMPANY, a Corporation, et al., *Appellees*.

McCLINTIC-MARSHALL COMPANY, a Corporation, and E. E. DAVIS & CO., a Corporation, and FAR WEST CLAY COMPANY, a Corporation, *Appellants*,

vs.

ANN DAVIS and R. T. DAVIS, Jr., as Executors of the Estate of R. T. DAVIS, Deceased, et al., *Appellees*.

WASHINGTON BRICK, LIME & SEWER PIPE COMPANY, a Corporation, *Appellant*,

vs.

McCLINTIC-MARSHALL COMPANY, a Corporation, et al., *Appellees*.

BEN OLSON COMPANY, a Corporation, *Appellant*,

vs.

McCLINTIC-MARSHALL COMPANY, a Corporation, et al., *Appellees*.

J. P. DUKE, as Supervisor of Banks of the State of Washington, and as successor in office of the defendant CLAUDE P. HAY, as State Bank Commissioner of the State of Washington, FORBES P. HASKELL, Jr., as Deputy Supervisor of Banks of the State of Washington, and SCANDINAVIAN AMERICAN BANK OF TACOMA, a Corporation, *Appellants*,

vs.

McCLINTIC-MARSHALL COMPANY, a Corporation, et al., *Appellees*.

UPON APPEALS FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF WASHINGTON, SOUTHERN DIVISION

REPLY BRIEF OF APPELLANT TACOMA MILLWORK SUPPLY CO. TO BRIEF OF J. P. DUKE, SUPERVISOR.

EDWIN H. FLICK,
CHARLES H. PAUL,
Attorneys for Appellant Tacoma Millwork Supply Company.
913-915 Hoge Building, Seattle, Washington.

PIONEER PRINTING CO., SEATTLE

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UPON APPEALS FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF WASHINGTON, SOUTHERN DIVISION

REPLY BRIEF OF APPELLANT TACOMA MILLWORK SUPPLY CO. TO BRIEF OF J. P. DUKE, SUPERVISOR.

We beg respectfully to present to this court a resume or review of the facts submitted in the

brief of appellant J. P. Duke, as Supervisor, with others.

We have no criticism of the facts contained in the statement of facts excepting as facts were inadvertently omitted or excepting as certain conclusions were drawn from the facts submitted at pages 2 to 36, inclusive, of said brief, to which conclusions we cannot subscribe.

$70,000.00 Mortgage.

It is suggested, page 3 of said brief, that the bank did not assume the mortgage known as the Penn Mutual mortgage, namely, the one of $70,000.00, so-called, nor did it agree to pay the same. On paper and without looking into the acts or the estoppels created by the parties, this is true.

But there was placed of record, through the act of men who were officers of the bank, with officers of the bank assisting in its construction, another mortgage, being the $600,000 mortgage, which recites, in so many words, that this is a first mortgage upon the same land covered by the $70,000.00 mortgage. This mortgage was placed of record subsequent to a warranty deed given by this banking corporation to the building company. (See page 1006-7-8 of Record). The resolutions there found or referred to speak of this warranty deed running in favor of the Building Company. In the

same resolutions reference is made to "a first mortgage for the principal sum of $600,000.00 to be executed by said Scandinavian-American Building Company upon all three lots." In the same resolutions this court will find that for this warranty deed the bank was to receive $350,000.00 worth of second mortgage bonds. In the same resolutions is found a reference to the $70,000.00 Penn Mutual mortgage. The two lots, 11 and 12, and the building thereon, were carried at $280,000.00 on the books of the company, which was supposedly the net value with the deduction of the $70,000.00 mortgage, already considered, and for that reason the bank was seeking $350,000.00 worth of the second mortgage bonds. (See p. 22 Oakley's brief, pp. 738 *et sequor*, Record).

Thus the bank was to eliminate the $70,000.00 Penn Mutual mortgage through the acceptance of an equivalent amount of second mortgage bonds. The agreement of the bank under these resolutions coupled with the record title when the appellant Millwork Company signed its contract presented practically this situation: That the bank had already purchased Lot 10 from Drury for the building company. This was unaffected by the $70,000.00 mortgage in any particular. The resolutions, plus the warranty deed, plus the recording of the $600,000.00 mortgage as a first mortgage is proof

positive that the bank on the adoption of the resolutions knew, and held out to the world, the proposal that the $600,000.00 mortgage was a first mortgage and that after that would follow immediately the second mortgage bonds, which were to wipe out the interest of the bank in Lots 11 and 12 and to wipe out the Penn Mutual mortgage, *which it was under absolute obligation to wipe out under the warranty deed dated February 25th, 1920, and recorded on the same day.* But the agreement to reserve to itself the protection of a second mortgage lien was never brought to the notice of these appellants nor was it ever placed of record.

The $600,000.00 mortgage was dated March 10th, 1920, and recorded on the 10th day of March, 1920. Charles Drury, the Chairman of the Board of Directors of the Bank, signed as President of the building company. J. V. Sheldon, Vice-President of the bank, signed this instrument as the Secretary of the building company.

The pertinent part of the resolution referred to adopted by the bank, which speaks of the payment for the lots conveyed by the bank to it, namely, Lots 11 and 12, is as follows:

> "Whereas, said Scandinavian American Building Company has agreed to execute and deliver to Scandinavian American Bank of Tacoma second mortgage bonds hereinbefore

referred to of the par value of $350,000 in payment for said real estate as soon as the same can expediently be prepared and be a second mortgage lien upon said premises, and

"Whereas, temporarily, said Scandinavian American Building Company will execute a certificate or agreement agreeing to so deliver said bonds as soon as the same can be executed as above provided."

Then follows the "Wherefore" clause, authorizing the president and cashier of the bank to convey the two lots for these bonds. (See pp. 1008-9 of Record).

The $600,000.00 mortgage recites that the property is, "free and clear of all incumbrances of every nature and kind whatsoever."

The resolution of the bank recites, as to this $600,000.00 mortgage that the building company "proposes to borrow $600,000.00 and execute therefor a first mortgage upon said premises."

The $600,000.00 mortgage was to produce a fund for the final completion of the building (Page 26—Appellant's opening brief). This is what this appellant relied on.

To say in the face of this testimony that the record was unaffected by any other instrument until after failure of the bank and the institution of this action is not a tenable premise. We find

this suggestion on page four of the bank commissioner's brief.

The bank had already received its certificate for the $350,000.00 worth of second mortgage bonds. Equity, of course, will regard that as done which it was agreed would be done and in the light of the certificate and in the light of the fact that the control of the building company rested with the bank it was through the laches of its own officers that the bonds themselves were not constructed. Therefore it seems only a reasonable rule to apply that the $70,000.00 mortgage shall be deemed to have been paid off when the certificate passed.

It was not the act of the bank commissioner, acting through Mr. Haskell, that is to be considered as the vital fact in the payment of the $70,000.00 mortgage.

Merely for the purpose of argument let us assume that Mr. Haskell did not have the authority to pay the $70,000.00 mortgage. What Mr. Haskell is seeking in this action is the foreclosure of rights under the $600,000.00 mortgage and is also seeking the foreclosure of the $70,000.00 mortgage, but the position of the bank commissioner must necessarily be bound by the record obligations of the bank, itself. So far as the $70,000.00 mortgage is concerned the bank expressly

agreed in its resolutions that it would take second mortgage bonds for this obligation, and it expressly warranted this property free and clear. It is true that it knew that there was to be a $600,000.00 first mortgage upon the place, but the property was to be free and clear so that the building company could put such a mortgage upon the property.

No record was made in the auditor's office of the plan to put out a second mortgage bond issue. No evidence, so far as this appellant is concerned, is in the record that they were advised that there would be a second mortgage bond issue. They were apprised that the $600,000.00 mortgage was to *be a first mortgage to be issued for completion monies and not available until the building was completed.* (Record p. 1126). It was also specially represented by officers of the building company, who were also officers of the bank, that there was $400,000.00 cash on hand.

The bank then stands in this position:

a. That it is seeking to *transmute a warranty deed into a warranty deed subject to a $70,000.00 mortgage.*

b. That it is seeking to place, behind a mortgage which the warranty deed represents as satisfied, a first lien upon the premises.

c. That while it received and accepted, volun-

tarily, while solvent, a certificate for second mortgage bonds, which was the full consideration for the transfer of Lots 11 and 12 and claiming this $70,000.00 mortgage, it is now claiming an interest in Lots 11 and 12 and claiming the right to have eked out of this property the $70,000.00 mortgage. The foreclosure of the $70,000.00 mortgage is sought (Record p. 84) claiming (Record p. 87) that all other claims asserted in these actions and cross actions were inferior and subsequent to said $70,000.00 mortgage. At page 89 of the record, *et sequor*, appears the further cause or second cross bill, which speaks of the purchase of the Drury lot at the instance of the building company by the bank for the sum of $65,000.00; the agreement to transfer Lots 11 and 12 for second mortgage bonds of the amount of $350,000.00 (Record pp. 90-91) and there is further suggested the fact that the building company failed to execute the second mortgage and to deliver the bonds mentioned, and on page 92, paragraph IV of said cross bill speaks of the right in equity to a lien in the nature of a purchase money mortgage on said premises and suggests, on page 94, that the claims of other lienors or claimants are inferior and subsequent.

For a third cross bill, beginning at page 94 of record, this cross complaint speaks of the $600,000.00, of its assignment to the bank, and

suggests the advance of $432,822.99 to the building company between June 25th, 1920, and January 15th, 1921, seeks the foreclosure of said $600,000.00 mortgage as collateral security for said advances. (Record p. 100). Claims that the interest of the remaining parties is inferior. (Record p. 103). Curiously, in the last total is included the stock purchase of $200,000.00 June 25th, 1920. Somewhere in this total amount must be found the $65,000.00 paid for the Drury lot, and as already shown in the opening brief. The only new money given after assignment was approximately $50,000.00, which again is reducible by over-drafts mentioned.

d. It is seeking to transmute a stock purchase, known, as Larson says, to practically all of the directors of the bank, being the total capitalization of the building company in the amount of $200,000.00, to a loan secured by a $600,000.00 first mortgage, and yet this amount was never carried as a loan until December 30th, 1920, (Record p. 1114) after the bank commissioner had directed, undoubtedly, such change, and no note of any kind was given up for entry representing this as a loan. (Record p. 1118).

e. It is seeking to displace the warranty of $400,000.00 cash on hand given to these contractors by officers of the building company, who were also

officers of the bank, which representations gave the builders security, by wedging in a mortgage security to cover the advances that the officers of the bank, operating for and with the building company, knew must stand for the representation that there was $400,000.00 cash on hand, since there was not one cent of cash on hand.

f. This bank is now taking to itself for the advances just mentioned, collateral security of this $600,000.00 mortgage, which was represented to the lien claimants, *would be held as completion monies*, and use this security for the advances claimed to have been made, even for the return of the purchase of the stock, in violation of the representative promises that there was $400,000.00 cash on hand, which, plus the $600,000.00 of completion monies, would practically finish the building so that no contractor need worry. Upon the faith of representations, made by the officers of the building company and the bank, who were, in effect, the active forces in both institutions, and, in effect, solely in control of both institutions, so far as executive work was concerned, these contractors went to work.

The bank, acting through the bank commissioner, is, therefore, violating the promises of *sole agents of both institutions*, that there were ample funds on hand, coupled with what would be produced

with the first mortgage, by attempting to use the first mortgage and the very ground upon which it rests as security to itself *to the disinterest of those receiving favorable promises through its officers*, who had full charge of all matters relating to the building company and to the bank, and as one of them expressed it: "Drury had the active charge of the building company (he was Chairman of the Board of Directors of the Bank) and that everything was left to Larson and he was the President of the bank", and as one reads the evidence, fostered the building project, engineered the loan for it and was the dominating spirit in all these troublesome matters.

g. The bank is now claiming the assignment of this $600,000.00 mortgage so that it might be collateralized for advances, or for advances already made. Mr. Larson says this was not the case; that Simpson was sick and that it was for that reason that the assignment was sought under the advice of the attorney for the bank, Finck, in Chicago (Record p. 1048). Larson says that he did not want to get the mortgage tangled up with his (Simpson's) estate. *Mr. Larson then says the $600,000.00 mortgage assignment was not taken wit hany idea of security or preference whatever.* (Record p. 1085. See also p. 554 of S. of F.). In another part of the record he rather recedes from

this position, but it will be conceded that a majority of the directors of the building company did not know of this assignment.

It was suggested in one part of Mr. Oakley's brief (page 15) that the testimony showed that when the $600,000.00 mortgage was arranged for it was understood that that would take up the $70,000.00 Penn-Mutual mortgage (Record p. 1045. S. of F. 545). While this language is used it is perfectly clear from the resolutions that the $350,-000.00 second mortgage bond issue was to take up the $70,000.00 mortgage. (See p. 1106 of Record where Mr. Larson says, "The building company was to pay $350,000.00 for the property and *the bank was to pay the mortgage that was on it and release it*"). The letter to Mr. Chilberg (Record p. 1059) mathematically shows this. At page 545 of the statement of facts Mr. Larson says, "Either the $70,000.00 was to be taken out of the $600,000.00 mortgage or the bank would have to pay it", but when the resolutions were finally drawn clearly the $70,000.00 was to be taken care of in the second mortgage bonds. (See also p. 554 S. of F.) It is clear, therefore, that the $600,000.00 mortgage was not to be collateral with the bank for its advances, but was to be reserved for the Metropolitan money, to be used in final completion of the building. In addition this appellant had no knowl-

edge of the agreement to take back second mortgage bonds.

The $200,000.00 Stock Purchase. Was it a Purchase or a Loan?

The records of the company, Exhibit 195, show O. S. Larson as the owner of 1996 shares of the capital stock of the building company. Chas. Drury, president, and J. V. Sheldon, secretary, certify to this, under date of June 25th, 1920. Under the same date the same officers certify that the Scandinavian American Bank is the owner of apparently the same block of stock. *Mr. Larson testified that he immediately transferred his certificate, when he got it, to the bank.* Mr. Sharpe indicates (Record p. 1114) that it was a purchase *and that no loan note ever appeared on the books* and no entry of any kind suggesting this until December 30th, 1921. Exhibit 190 (Record pp. 1034-1035) shows this as a purchase, being listed under "Stocks and Securities" in the bank accounts. Mr. Ogden, the cashier, says that *the bank records show that this is a purchase*, but later the bank charged interest on the money it bought the stock with (Record p. 1033). Mr. Larson says he subscribed for the stock in behalf of the bank. *That the certificates marked Exhibit 195 are all in Mr. Freeman's handwriting*, Mr. Freeman being a

partner of Mr. Williamson, a director, (Record pp. 1042-1044). At page 1092 of Record Mr. Larson says, "I admit buying the stock and I want to say that the *Board of Directors knew all about it.* It was passed on by Mr. Williamson as being perfectly legal and above board in every respect. *They never* objected to it and they knew all about it. * * * The matter was brought up at a meeting of the board * * * in April and again in December, 1920, and very thoroughly discussed and understood."

Were the Two Corporations Identical or Were the Managing Officers of the Two Corporations Identical?

The directors of the bank were also the directors of the building company. Larson was the active spirit in the bank, assisted by Drury, and Larson managed the affairs of the building company, assisted by Sheldon, vice president and director of the bank, and Ogden, cashier of the bank and treasurer of the building company (Record p. 1042. See page 8 of opening brief).

The directors were practically identical, and those directors who handled the business of the bank in large substance, were also directors who were in any sense active at all in the building

company. These were Larson, Drury and Lindeberg and Williamson.

Reliance on Title

It is suggested that none of the lien claimants testified that they relied upon any warranted title to the property. It would appear, however, that under the representations made such reliance is either expressly stated or thoroughly implied.

R. T. Davis says that he relied upon the representations that the $600,000.00 mortgage was definitely financed (Record p. 700). This would, of course, mean that this was a $600,000.00 first mortgage.

George Davis says that this representation was definitely made to him, that the $600,000.00 would be a first mortgage on the property (Record p. 729), that the building company was the full owner of the property with nothing against it except this mortgage (opening brief p 28).

Before leaving the fact side of this brief I think we ought to suggest once more to this court that Mr. Wells, the superintendent of the building, duly authorized in the premises, accepted this material in both warehouses. That it was specially fabricated and was useless elsewhere, and was again tendered to the receiver on his appointment and refused, and that offer was made to the trial court that it enter an order classifying this material as

part of the building, which offer was not acted upon. In the light of the foregoing statement the following language in the earliest case on the subject in Washington, namely, *Fox v. Utter*, 6 Wash. 301, is peculiarly applicable:

> "Time must have been made the essence of the contract to avoid this rule, if the reason for refusal to receive is based on the lateness of delivery. And if upon tender of the article, the purchaser allege defects of construction or departure from the contract he must point them out, and give the maker a chance to remedy the difficulty. This is especially so where a peculiar article has been made according to a design of the purchaser, and will be of less or no value to others. This contract was one for labor rather than of sale. *Davis v. Downs*, 4 Mich. 530; *Bement v. Smith*, 15 Wend. 493."

The language 'this is especially so where a peculiar article has been made according to a design of the purchaser and will be of less or no value to others" was moulded to fit a case of special interior fabrication. This was a case where a monument was made and it was held that if there was opportunity to accept or reject, the law, in effect, would presume an acceptance.

Again we find the following expression in the

same case:

> "In cases of the manufacture of specific articles upon order a tender of the manufactured articles is sufficient."

This was the reply of the Supreme Court to the claim that no deliveries could be found unless there was first found to be an acceptance by the party to whom delivery was to be made.

Was $600,000.00 Mortgage to be Used as Collateral?

We submit also this, in response to certain statements made, pages 30-31 and 32 of Supervisor's Brief, relating to the purpose of placing the $600,000.00 mortgage at Simpson's disposal.

We submit the fact that the building company secretly intended to use this mortgage as collateral, and did so, or that it secretly arranged with Simpson to obtain interim monies under this mortgage and would not aid the bank in its pretended position of bona fide holder of this mortgage for collateral purposes because its officers, who solely directed its policies, Larson and Drury, had represented to the two Davis brothers, the manager and assistant manager of the appellant company, that this mortgage was to be preserved to produce completion monies and that the building company had on hand $400,000.00 in cash, and to prove it told Davis to come

down in the morning and get $15,000.00, which he did (Record p. 695). That Davis gave a note for $15,000.00 and each time the note was renewed Larson agreed that it was to be taken out of the last estimate due on the building although the note ran to the bank. The writings between the bank and the Metropolitan Insurance Company relating to interim funds and its secret handling of this special $600,000.00 mortgage could not affect this appellant in the circumstances.

It is suggested that this mortgage and the entry carried in connection therewith were held as a real estate loan, citing pages 1026-1030 of Record, Exhibits 185-187-188, but Exhibit 185, for the first time, expresses a real estate transaction under date of December 9th, 1920; Exhibit 187 expresses a real estate loan under date of December 9th, 1920, and Exhibit 188 expresses the interest on this supposed loan December 31st, 1920. This last exhibit shows a total of $9,133.25 and is the interest on the capital stock purchase, now called the loan, the interest on the Drury lot purchase, again called the loan, and the interest on $350,000.00. All these transactions were transmuted from direct sales or purchases into a loan status, we are satisfied, at or subsequent to the last examination by the bank examiner.

Sharpe, in his testimony already submitted, could

not find them as loans, but found them in their true status as originally entered; the stock a direct purchase by the bank, the Drury lot purchased by the bank for the building company and the $350,000.00 transaction, the second mortgage bonds, representing the sale of lots 11 and 12 *with the Penn-Mutual mortgage, in effect, paid.*

Under the heading, "The Bank Commission was not a agent of the bank," and the headings following down through to page 106 of the Supervisor's Brief, we deal with the validity, in effect, of the $70,000.00 first mortgage and the principal argument, we deem, is made in this premise to the effect that the bank commissioner had no power to pay this mortgage.

If a bank has made a valid contract then, of course, it would be futile to say that the commissioner could break such contract and change the status of parties who had relied upon the fulfillment of this contract. The lien claimants relied upon the fact that there was no other mortgage to remain upon this property except the $600,000.00 mortgage. The bank records show such an agreement. The commissioner simply carried out the obligation of the bank under its warranty deed to clear this property of any incumbrances. This appellant, at least, relied upon the fact that this property was free and clear, excepting for the com-

pletion money mortgage. It is for this reason that the authorities submitted by Mr. Oakley, we believe, are not in point.

This appellant acted upon the assurance given as to title and would now be severly jeopardized if this $70,000.00 mortgage was re-established.

We have already dealt with the question of the purpose of the $600,000.00 mortgage and its validity. This is treated at pages 106 *et sequor* of the Supervisor's Brief. Here, again, there can be no contention as to the validity of a mortgage securing future advances, but in this case this appellant, at least, was assured that the $600,000.00 mortgage was to be preserved to furnish completion monies, that is, to pay the final $600,000.00 due on the building, supplementing the representation that the building company had $400,000.00 cash on hand for immediate use, or what one might term the interim monies. Thus, the authorities on future advances would not apply since it was the representation that was relied upon that this fund would be kept for final completion of the building (Record pp. 695-697-700-706).

On page 157 of the Supervisor's Brief we find the question argued as to whether the bank is entitled to a purchase money mortgage. Here again we have nothing to apprise the lienors of a claim to $350,000.00 either as a vendor's lien or as a

second mortgage lien. The bank agreed to take $350,000.00 of second mortgage bonds. It did not disclose this purpose to this appellant, at least, but put of record a full warranty deed which had the effect of obliterating the $70,000.00 mortgage. Relying, therefore, upon the status of the title as so represented, this appellant had a right to rely upon $400,000.00 of cash; $600,000.00 to be kept carefully as a completion fund with full title in the building company. It did so rely. (Record pp. 703-705. See also particularly pages 695 and 700 of Record.)

Respectfully submitted,

EDWIN H. FLICK,

CHARLES H. PAUL.